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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 988

ALLIED CENTRAL STORES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 18–42) are not officially reported. The opinion of the court of appeals (Pet. 1a–4a) is reported at 339 F. 2d 503.[1]

JURISDICTION

The judgment of the court of appeals was entered on December 17, 1964. The petition for a writ of certiorari was filed on March 15, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, net operating losses sustained by petitioner

[1] "Pet." references are to the petition for a writ of certiorari, and "R." references are to the separately bound Appendix A to petitioner's brief in the court of appeals.

before its merger with three other corporations could be carried forward to offset the income earned in post-merger years by the merged corporations.

STATUTES INVOLVED

The pertinent portions of Sections 23 and 122 of the Internal Revenue Code of 1939 and Sections 172, 381, 382, 393, 394 and 7851 of the Internal Revenue Code of 1954 are set forth in the Appendix, pp. 9–16, *infra*.

STATEMENT

Prior to 1953, petitioner, a wholly-owned subsidiary of Allied Stores Corporation, was the owner-operator of a single department store in Kansas City, Missouri. In 1953, Heer's, Inc., which owned a department store in Springfield, Missouri, and was also a wholly-owned subsidiary of Allied Stores, was merged into petitioner. In 1956, two other corporate subsidiaries of Allied Stores—L. S. Donaldson Company and The Golden Rule—which together owned five department stores in Minnesota and South Dakota, also were merged into petitioner (Pet. 1a; R. 19–20).

Petitioner reported net operating losses on its federal income tax returns for the taxable years ending January 31, 1951, 1952 and 1954. It claimed the right to carry forward these losses to offset income which had been realized from the operations of the corporation after the merger. Respondent disallowed the loss carryovers. Both the Tax Court and the court of appeals held that the "continuity of business enterprise" test enunciated in *Libson Shops, Inc.* v. *Koeh-*

ler, 353 U.S. 382, precluded the offset of petitioner's post-merger income by pre-merger losses (Pet. 2a; R. 22–23). Petitioner argued alternatively that the *Libson Shops* rule did not apply to the loss year ending January 31, 1954, for the asserted reason that Section 382(b) of the 1954 Code was the exclusive limitation on loss carryovers from and after 1954. The court held that the application of Section 382(b) was expressly limited to mergers occurring after June 22, 1954, so that the provision had no bearing on the question whether pre-merger losses could be offset against petitioner's gains after the 1953 merger of Heer's, Inc., into petitioner (Pet. 3a–4a).

ARGUMENT

1. *In Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, sixteen corporations operating retail stores selling women's apparel were merged into a seventeenth corporation which had been providing management services for the sale corporations. All of the corporations were owned by the same individuals, whose proportionate ownership interests were the same before and after the merger. Three of the sales constituents incurred operating losses before and after the merger. The surviving corporation attempted to carry forward the pre-merger losses to offset income of the post-merger consolidated enterprise. Holding that the surviving corporation was not the same "taxpayer" as its pre-merger constituents within the meaning of Section 122(b) of the 1939 Code (pp. 9–10, *infra*), and observing that the purpose of the carryover provisions was not to give a merged taxpayer

advantages over others who did not merge, this Court concluded that (353 U.S. at 390) "petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced by substantially the same business which incurred the losses."

The present case comes squarely within the *Libson Shops* principle. Petitioner was originally the owner-operator of a single unprofitable store in Kansas City, Missouri. Its parent corporation then attempted to carry forward, through successive mergers with other subsidiaries conducting similar operations, petitioner's net operating losses incurred in pre-merger taxable years. Following these mergers, petitioner was the owner-operator of a chain of seven stores located in various cities in Missouri, Minnesota, and South Dakota, but petitioner could make no showing that the same business (*i.e.*, the Kansas City store) which had suffered the net operating losses also produced the income against which petitioner sought to offset these losses. In effect, petitioner's parent corporation sought to accomplish the very same result by merging three other corporations into petitioner that the shareholders in *Libson Shops* tried to achieve by merging its 17 corporations.

Petitioner contends that this case is distinguishable from *Libson Shops* for three reasons: (1) *Libson Shops* does not apply where the corporation seeking the benefit of the carryover is the same legal entity which sustained the losses; (2) there is no clear and workable standard for determining whether the business activity which sustained the losses is the same business producing the income to be offset by such

losses; and (3) *Libson Shops* does not apply where there has been no change in stock ownership (Pet. 7–17). None of these arguments has merit.

a. The courts of appeals which have applied *Libson Shops* have unanimously held that it makes no difference in the application of the principle whether or not it is the loss corporation which technically survives the merger. *Julius Garfinckel & Co.* v. *Commissioner*, 335 F. 2d 744 (C.A. 2), certiorari denied, 379 U.S. 962; *Norden-Ketay Corp.* v. *Commissioner*, 319 F. 2d 902 (C.A. 2), certiorari denied, 375 U.S. 953; *Mill Ridge Coal Co.* v. *Patterson*, 264 F. 2d 713 (C.A. 5), certiorari denied, 361 U.S. 816; *Commissioner* v. *Virginia Metal Products, Inc.*, 290 F. 2d 675 (C.A. 3), certiorari denied, 368 U.S. 889; *Willingham* v. *United States*, 289 F. 2d 283 (C.A. 5), certiorari denied, 368 U.S. 828; *J. G. Dudley Co.* v. *Commissioner*, 298 F. 2d 750 (C.A. 4); *Hwyler's* v. *Commissioner*, 327 F. 2d 767 (C.A. 7); *Federal Cement Tile Co.* v. *Commissioner*, 338 F. 2d 691 (C.A. 7); *Foremost Dairies, Inc.* v. *Tomlinson* (C.A. 5), decided February 11, 1965, 15 A.F.T.R. 2d 362; *Fawick Corp.* v. *Commissioner* (C.A. 6), decided March 25, 1965, 15 A.F.T.R. 2d 617. It would obviously serve no intelligible legislative purpose to have the availability of the tax benefit hinge upon whether the merged entity bears the name and charter of the loss corporation or of one of the other merging bodies.

b. *Libson Shops* established that a ladies' ready-to-wear shop in one location is not substantially the same business as another ladies' ready-to-wear shop with different assets at a different location. It follows from that decision that the single Kansas City department

store owned and operated by petitioner prior to the 1953 merger was not the same business as the other department stores in other locations which were merged into it.[2]

c. There was no greater change in stock ownership in *Libson Shops* than in the present case; in both instances stockholders owned the resulting corporation in exactly the same proportion that they had previously owned the constituent corporations involved in the merger. The fact that Allied Stores owned all of petitioner's stock as well as the stock of the merged corporations only supports the observation in *Libson Shops* (353 U.S. at 388): "If petitioner is permitted to take a carry-over * * * businesses have acquired by merger an opportunity that they elected to forego when they chose not to file a consolidated return."

2. Petitioner also asserts (Pet. 17–19) that a conflict exists between this case and the district court decision in *Jackson Oldsmobile, Inc.*, v. *United States*, decided November 13, 1964, 15 A.F.T.R. 2d 035 (M.D. Ga. 1964), on appeal to C.A. 5. The *Jackson Oldsmobile* decision does conflict in principle with the present case, but it is being appealed to the Fifth Circuit.

---

[2] Petitioner contends that the present case presents the issue reserved in footnote 9 of the *Libson Shops* opinion. 353 U.S. at 390, n. 9 (Pet. 10–12). But that footnote was obviously not referring to a situation in which the business of one wholly-owned subsidiary is taken over by another wholly-owned subsidiary of the same parent. When the new business is nothing more than a wholly-owned subsidiary of the same parent, the merger amounts to an attempt by the parent to set off one operation's loss against the subsequent taxable income of another—precisely what the shareholders sought to do in *Libson Shops*.

Since that court recently cited the present decision with approval in *Foremost Dairies, Inc.* v. *Tomlinson*, decided February 11, 1965, 15 A.F.T.R. 2d 362, there is reason to believe that the court of appeals will reverse the *Jackson Oldsmobile* decision. In any event, a conflict between a court of appeals decision and a district court decision in another circuit is not an adequate basis for review by this Court.

3. Petitioner's argument (Pet. 20–24) that the *Libson Shops* principle does not apply to losses incurred in its taxable year ended January 31, 1954, because of Sections 381 and 382 of the 1954 Code, is equally without substance. Sections 393(a) and 394 (a) and (c) of the 1954 Code (pp. 15–16, *infra*), establish that neither Section 381(a) nor Section 382(b) applies to mergers taking place prior to June 22, 1954.[3] The merger of Heer's into petitioner occurred on October 31, 1953, which was before the applicable date, and petitioner made no attempt to segregate the profits of Heer's and those of the corporations which were merged into petitioner after 1954.

---

[3] Taxpayer erroneously contends (Pet. 23) that the reference to Section 172 in Section 381(c) means that the effective date of Sections 381 and 382 depends upon the effective date of Section 172. The cross reference in Section 381(c) merely requires that for purposes of Section 381(a) the net operating loss carryovers shall be computed under Section 172, subject to specified conditions and limitations. But this computation applies only after the effective date of Section 381, which is specified in Sections 393(a) and 394(a).

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CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL 1965.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [as added by Sec. 211(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

(26 U.S.C., 1952 ed., 23.)

* * * * *

SEC. 122 [as added by Sec. 211(b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [as amended by Sec. 105(e)(3)(A) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Sec. 215(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—

* * * * *

(2) *Net operating loss carry-over.*—

* * * * *

(B) *Loss for taxable year beginning after 1949.*—If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years, except that the

carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year, without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1949, shall be reduced by the amount, if any, of the net income for the preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for such preceding taxable year without regard to such net operating loss and without regard to any reduction specified in subsection (c).

* * * * *

(c) [as amended by Sec. 105(e)(3)(B) and Sec. 153(b) of the Revenue Act of 1942, *supra*, and Sec. 121(c)(2) of the Revenue Act of 1950, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds in the case of a taxpayer other than a corporation, the net income

computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credits provided in section 26 (h) and (i)).

* * * * *

(26 U.S.C., 1952 ed., 122.)

Internal Revenue Code of 1954:

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to which loss may be carried.*—A net operating loss for any taxable year ending after December 31, 1953, shall be—

(A) a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

(B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

(c) *Net Operating Loss Defined.*—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

* * * * *

(e) *Law Applicable to Computations.*—In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other

taxable year shall be made under the law applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years, whether they begin before, on, or after January 1, 1954.

* * * * *

(g) *Special Transitional Rules.*—

(1) *Losses for taxable years ending before January 1, 1954.*—For purposes of this section, the determination of the taxable years ending after December 31, 1953, to which a net operating loss for any taxable year ending before January 1, 1954, may be carried shall be made under the Internal Revenue Code of 1939.

* * * * *

(h) *Cross References.*—

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

(26 U.S.C. 172.)

* * * * *

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) *General Rule.*—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

* * * * *

(c) *Items of the Distributor or Transferor Corporation.*—The items referred to in subsection (a) are:

(1) *Net operating loss carryovers.*—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

* * * * *

(26 U.S.C. 381.)

SEC. 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS.

* * * * *

(b) *Change of Ownership as the Result of a Reorganization.*—

(1) *In General.*—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the "loss corporation"), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corpo-

ration ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) *Reduction of net operating loss carryover.*—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

(3) *Exception to limitation in this subsection.*—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion.

(4) *Net operating loss carryovers to subsequent years.*—In computing the net operating loss carryovers to taxable years subsequent to a taxable year in which there was a limitation applicable to a net operating loss carryover by operation of this subsection, the income in such taxable year, as computed under section 172(b)(2), shall be increased by the amount of the reduction of the total net operating loss carryover determined under paragraph (2).

(5) *Attribution of ownership.*—If the transferor corporation or the acquiring corporation owns (immediately before the reorganization) any of the outstanding stock of the loss corporation, such transferor corporation or acquiring corporation shall, for purposes of this subsection, be treated as owning (immediately after the reorganization) a percentage of the fair market value of the acquiring corporation's outstanding stock which bears the same ratio to the percentage of the fair market value of the outstanding stock of the loss corporation (immediately before the reorganization) owned

by such transferor corporation or acquiring corporation as the fair market value of the of the total outstanding stock of the loss corporation (immediately before the reorganization) bears to the fair market value of the total outstanding stock of the acquiring corporation (immediately after the reorganization).

(6) *Stock of corporation controlling acquiring corporation.*—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

* * * * *

(26 U.S.C. 382.)

PART VI—EFFECTIVE DATE OF SUBCHAPTER C

* * * * *

SEC. 393. EFFECTIVE DATES OF PARTS III AND IV.

(a) *General Rule.*—Except as otherwise provided in this subchapter, parts III and IV shall take effect on June 22, 1954.

* * * * *

(26 U.S.C. 393.)

SEC. 394. EFFECTIVE DATE OF PART V.

(a) *Section 381.*—Except as otherwise provided in this subchapter, section 381 shall apply to liquidations and reorganizations, the tax treatment of which is determined under this Code.

(b) *Section 382(a).*—For purposes of applying the special limitation on net operating loss carryovers in section 382(a), the beginning of the taxable years specified in clauses (i) and (ii) of section 382(a)(1)(A) shall be considered to be the beginning of such taxable years or June 22, 1954, whichever occurs later.

(c) *Section 382(b).*—Section 382(b) shall apply to reorganizations, the tax treatment of which is determined under this Code.

(26 U.S.C. 394.)

* * * * *

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(a) *General Rules.*—Except as otherwise provided in any section of this title—

(1) *Subtitle A.*—

* * * * *

(C) * * * The provisions of the Internal Revenue Code of 1939 superseded by provisions of subtitle A of this title the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in subtitle A of this title, but shall be applicable only to the period prior to the taking effect of the corresponding provision of subtitle A.

* * * * *

(26 U.S.C. 7851.)

U.S. GOVERNMENT PRINTING OFFICE: 1949